DEPARTMENT OF STATE REVENUE

04-20060530.LOF

LETTER OF FINDINGS: 06-0530
Sales Tax
For the Years 1999, 2000, 2001, 2002, 2003, 2004, 2005

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ISSUES

I. Sales Tax – Imposition.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-2; IC § 6-2.5-1-5; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-7; IC § 6-2.5-4-1; IC § 6-8.1-5-1; 45 IAC 2.2-4-1; 45 IAC 2.2-4-3; 45 IAC 2.2-4-21; 45 IAC 2.2-4-22; 45 IAC 2.2-4-23; Commissioner's Directive 23 (April 2004); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Ind. Dep't of State Revenue v. Trump Ind.*, 814 N.E.2d 1017 (Ind. 2004); *Galligan v. Ind. Dep't. of Revenue*, 825 N.E.2d 467 (Ind. Tax Ct. 2005); *Frame Station, Inc. vs. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002).

Taxpayer protests the imposition of use tax on some items.

II. Tax Administration – Ten Percent Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the proposed assessment of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation engaged in the business of design, fabrication, sale, and installation of outdoor signs. Taxpayer has filed Indiana income tax returns since 1999. Taxpayer has no Indiana employees. Taxpayer sells to customers within Indiana on a regular basis. The signs are manufactured out-of-state and delivered to the customers' Indiana jobsite with installation sometimes performed by Taxpayer's employees and sometimes by subcontractors.

The Indiana Department of Revenue (Department) conducted a sales and use tax audit of Taxpayer for the years 1999 through 2005. The Department assessed additional sales tax as a result of the audit on the basis that the signs Taxpayer sold to Indiana customers and installed for them in Indiana are tangible personal property purchased in a retail transaction and therefore subject to Indiana sales tax. During the audit period some signs were picked up at the Taxpayer's out-of-state location by the customer or their common carrier. These transactions were not subject to Indiana sales tax. Taxpayer protested the assessment on the basis that the signs are real property and therefore not taxable. A hearing was held. This Letter of Findings ensues. Additional facts will be presented as necessary.

I. Sales Tax – Imposition.

DISCUSSION

The Department assessed additional sales tax as a result of the audit on the basis that the signs Taxpayer sold, as a retail merchant, to Indiana customers and delivered and installed for them in Indiana are tangible personal property subject to Indiana sales tax.

Taxpayer protested the assessment on the basis that the signs are real property and therefore not subject to Indiana sales tax. Taxpayer argued that the signs it sells to and installs for Indiana customers are permanently affixed to real property and therefore not subject to sales tax. Second, Taxpayer argues in the alternative that it is a contractor, not a retail merchant, and therefore it would only owe tax on materials, not labor.

The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-8.1-5-1(b), (c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

As a preliminary matter, this Letter of Findings notes that outdoor signs take many forms and are installed in various ways. For example, some outdoor signs are attached to the façade of a customer's building, others are located alongside the customers' buildings either in the form of what the industry generally refers to as monument signs (where the sign is mounted onto a relatively low, free-standing concrete footing or foundation) or pylon signs (where the sign is mounted onto frames on a tall, free-standing structure usually consisting of one or more metal poles imbedded in a concrete foundation; often, the pylon structure can house multiple signs and can be more than a simple pole structure). The monument and pylon signs share the characteristics of being free-standing and having a base or foundation.

In its December 13, 2006 protest letter, Taxpayer describes the signs at issue as "large signs either attached to buildings . . . or freestanding signs mounted into huge concrete footings." In restating its protest in the November 30, 2007 letter, referenced above, the Taxpayer refers to "pylon signs" and attaches six pictures of signs Taxpayer has installed (not necessarily those that are the subject of the protest). Based on the descriptions in the preceding paragraph, the pictures included illustrate five pylon signs and a monument sign.

As part of its initial protest, Taxpayer provided documentation that includes invoices and project reports. Taxpayer provided invoices for most of the retail transactions which are the subject of its protest. While some of the invoices and project reports specifically refer to pylon signs, most of these documents do not establish that the signs at issue are specifically pylon signs or any other type of sign.

Since Taxpayer's business involves the fabrication of a wide range of signs, the nature of which may have implications as to the assessment of Indiana sales tax, this Letter of Findings cautions that its analysis will specifically address Indiana sales tax issues relating to façade signs, monument signs, and pylon signs, all as described above.

Taxpayer custom makes its Indiana customers' signs out-of-state. Taxpayer then delivers the signs to its customers' Indiana locations. Taxpayer also installs the signs at its Indiana customers' locations.

Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). The person who acquires property in a retail transaction is liable for the tax on the transaction and, unless exempt, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. IC § 6-2.5-2-1(b) The retail merchant shall collect the tax as agent for the state. *Id*.

Indiana imposes a use tax "[o]n the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2.

Based on the above, in order for sales (or use) tax to apply, there must be a retail transaction of tangible personal property.

IC § 6-2.5-1-2(a) defines a "retail transaction" to mean:

> "Retail transaction" means a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1, that constitutes making a wholesale sale as described in IC 6-2.5-4-2, or that is described in any other section of IC 6-2.5-4.

IC § 6-2.5-4-1 defines "retail merchant" and "selling at retail" in part:

> (a) A person is a retail merchant making a retail transaction when he engages in selling at retail.
> (b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:
> (1) acquires tangible personal property for the purpose of resale; and
> (2) transfers that property to another person for consideration.
> (c) For purposes of determining what constitutes selling at retail, it does not matter whether:
> (1) the property is transferred in the same form as when it was acquired;
> (2) the property is transferred alone or in conjunction with other property or services; or
> (3) the property is transferred conditionally or otherwise.

For most of the years protested, the Indiana legislature had not defined "tangible personal property" for sales and use tax purposes.

In *Ind. Dep't of State Revenue v. Trump Ind.*, 814 N.E.2d 1017 (Ind. 2004), the Indiana Supreme Court held that because the General Assembly did not define "tangible personal property" for purposes of the sales and use tax, it would apply the ordinary meaning of the phrase. The court relied on Black's Law Dictionary (8th ed. 2004) definition of "personal property":

> When the Indiana General Assembly chooses a word without defining it, the court "must examine the statute as a whole and attribute the common and ordinary meaning to the undefined word, unless doing so would deprive the statute of its purpose or effect." *Consolidation Coal Co. v. Ind. Dep't of State Revenue*, 583 N.E.2d 1199, 1201 (Ind. 1991) (citations omitted). Indeed, the statutes direct us that "words and phrases shall be taken in their plain, or ordinary and usual, sense." I.C. § 1-1-4-1 (1998). See also *Ind. Dep't of State Revenue v. Hardware Wholesalers*, 622 N.E.2d 930, 932-33 (Ind. 1993); Cf. *UACC Midwest, Inc. v. Ind. Dep't of State Revenue*, 667 N.E.2d 232, 237 (Ind. Tax Ct. 1996). **Because the General Assembly did not define "tangible personal property" for purposes of the sales and use tax, we apply the ordinary meaning of the phrase. Black's Law Dictionary defines personal property as "any movable or intangible thing that is subject to ownership and not classified as real property." Black's Law Dictionary 1254 (8th ed. 2004).** By this rather ordinary definition, a casino riverboat, like any other boat, is "tangible personal property." As such, its purchase rendered it subject to use tax.
> *Id.* at 1021. (**Emphasis added**).

Subsequently, effective January 1, 2004, the legislature, IC § 6-2.5-1-27, defined "tangible personal property" for sales and use tax purposes as:

> "Tangible personal property" means personal property that:
> (1) can be seen, weighed, measured, felt, or touched; or
> (2) is in any other manner perceptible to the senses.
> The term includes electricity, water, gas, steam, and prewritten computer software.

The signs that Taxpayer fabricates and sells are specific to the customers to whom they are sold. They are custom-fabricated as markers that identify and advertise the businesses of Taxpayer's customers. Typically business owners do not intend to leave the signs in place beyond the life of the business. They are placed either

on the businesses' building façades or on structures alongside the buildings as is the case with pylon signs. In most jurisdictions, if a business closes or relocates, by local ordinance the signs must be removed within a certain period of time. These signs are clearly movable and are tangible personal property.

Therefore, based on the above and the facts set forth, Taxpayer is clearly selling tangible personal property (the signs) at retail and the transactions are therefore subject to the Indiana sales tax.

Taxpayer argues that the signs it sells are incorporated into real property and are therefore not subject to Indiana sales tax. Even if Taxpayer's argument that the signs are incorporated into real property is accepted, 45 IAC 2.2-4-21(a) states in relevant part that "the conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." Therefore, even if the Department accepts Taxpayer's argument that the signs it sells are then incorporated into real property, the sale of the signs would still be subject to Indiana sales tax.

Furthermore, in *Trump*, the Indiana Supreme Court discussed the possible dual characterization of a physical item for different tax purposes:

> The same physical item can be transformed from personalty to realty in many contexts. A rudimentary example is that of a fixture bought at a retail store and later installed in a building. The purchaser of the fixture is subject to sales tax (or use tax if bought outside Indiana) because the item is personalty at that point. [. . .] The General Assembly has the power to classify a single piece of property [. . .] first as realty and then as personalty to effectuate independent statutory schemes of taxation. See, e.g., *United States Lines, Inc. v. State Bd. of Equalization*, 182 Cal. App. 3d 529, 535, 227 Cal. Rptr. 347 (1986) (classification of affixed equipment as realty does not exclude classification of the same equipment as tangible personal property for sales tax purposes).
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> *Trump*, 814 N.E.2d at 1021.

Therefore, again, Taxpayer is clearly selling tangible personal property at retail and the transactions are therefore subject to the Indiana sales tax.

Pursuant to IC § 6-2.5-4-1(e) the amount of the retail transaction that is subject to sales tax includes "the price of the property transferred" and "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." Further, 45 IAC 2.2-4-1(b)(3) provides the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail."

In *Galligan*, the Indiana Tax Court addressed the assessment of tax on services in "mixed transactions"; i.e., where "tangible personal property is sold in order to complete a service contract, or where services are provided in order to complete the sale of tangible personal property." *Galligan v. Ind. Dep't. of Revenue*, 825 N.E.2d 467, 480 (Ind. Tax Ct. 2005). The court, in acknowledging that in mixed transactions it is often difficult to distinguish the taxable sale of property from the non-taxable sale of services, discusses the parameters set forth by the legislature for imposing tax on these transactions. *Id*.

> First, taxable property does not escape taxation merely because it is transferred in conjunction with the provision of non-taxable services. IND. CODE ANN. § 6-2.5-4-1(c)(2) (West 1994) (amended 2004). Second, services, generally outside the scope of taxation, are subject to tax to the extent the income represents "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." A.I.C. § 6-2.5-4-1(e)(2) (emphasis added). Finally, the legislature imposes tax on services that are provided in a retail unitary transaction, "a unitary transaction that is also a retail transaction." IND. CODE ANN. § 6-2.5-1-2(b) (West 1994). A unitary transaction is one which "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." IND. CODE ANN. § 6-2.5-1-1(a) (West 1994). *Id.* at 480-481.

A unitary transaction is a transition that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." IC § 6-2.5-1-1(a).

In *Frame Station, Inc. vs. Indiana Dep't of Revenue*, 771 N.E.2d 129 (Ind. Tax Ct. 2002), the court held that when customers were charged separate amounts for labor and materials for custom framing services the labor charges were subject to sales tax. *Id.* at 131. In arriving at that decision, the court reasoned that the focus of analysis should be "whether [Taxpayers'] services were preformed before or after it transferred property to its customers." Id. The court found that services that are performed prior to the transfer of the property are taxable, and services that are performed after the transfer of the property are taxable to the extent that the services represent a "unitary transaction" and are "inextricable and indivisible" from the property being transferred. *Id*.

In summary, when services are performed or work is done to tangible personal property before the tangible personal property is transferred to the purchaser, then the amount of charges for the services or work done is subject to sales tax. It does not matter whether these charges are separately stated or part of the unitary price of the transaction; though, clearly, if the pre-transfer services are separately stated, they are subject to sales tax.

Services provided after the transfer of the tangible personal property are not subject to Indiana sales tax if such services are separately stated; i.e., not part a unitary contract.

Taxpayers invoices include delivery/freight charges.

IC § 6-2.5-4-1 states in relevant part:

(e) The gross retail income received from selling at retail is only taxable under this article to he extent that the income represents:

(1) the price of the property transferred, without the rendition of any service; and

(2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

For purposes of this subsection, a transfer is considered to have occurred after delivery of the property to the purchaser.

Furthermore, the statute that defines "gross retail income" states that for purposes of that statute, "[D]elivery charges are charges by the seller for preparation and delivery of the property to a location designated by the purchaser of property, including but not limited to transportation, shipping, postage, handling, crating, and packing." IC § 6-2.5-1-5. For Taxpayer's reference, 45 IAC 2.2-4-3 and Commissioner's Directive 23 (April 2004) provide additional clarification of Indiana sales tax treatment of delivery charges.

Delivery charges are bona fide service charges made prior to transfer of property to the purchaser and are therefore part of the gross retail income derived from the transaction. Delivery charges are therefore generally taxable.

Therefore, based on the above, where Taxpayer separately states on its invoices a delivery or freight charge to its customers, that charge is subject to the Indiana sales tax.

After Taxpayer delivers the signs to its Indiana customers, Taxpayer then installs the signs. IC § 6-2.5-1-5(b)(6), specifically excludes installation charges from "gross retail income." Furthermore Commissioner's Directive 23 (April 2004) which supersedes Commissioner's Directive 22 (January 2004) states:

As of March 18, 2004, separately stated installation charges are not subject to sales tax. For the period of January 1, 2004 through March 17, 2004, such charges were subject to sales tax. Sales tax should have been collected on such charges during that period.

Installation charges that are not separately stated from the selling price of an item or the delivery charge for an item will continue to be subject to sales tax.

The Commissioner's directive references a two-month period, between January 1, 2004 and March 17, 2004 where installation charges were taxable. Prior to January 1, 2004, installation charges that were separately stated were generally not subject to Indiana sales tax.

Therefore, based on the above, separately stated installation charges between January 1, 2004 and March 17, 2004 are subject to Indiana sales tax.

Also, installation charges are excluded from "gross retail income" only when separately stated by the transferor of the tangible personal property. When the installation service in part of a unitary transaction it is subject to Indiana sales tax. A unitary transaction is defined at IC § 6-2.5-1-1(a) as follows:

"[U]nitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

Pursuant to this statutory definition, services are subject to the sales tax when they are provided in conjunction with the transfer of tangible personal property as a unitary transaction. Therefore, any service not separately stated, including installation services, is subject to Indiana sales tax under the full price of the unitary transaction.

As stated earlier, Taxpayer provided invoices for most of the protested transactions. The invoices contain charges for such items as "sign package," "project management," "install," "installation," "fees, permits..." "freight to job site," "freight," "rush charges," "additional work," etc... Given the large number of invoices presented by Taxpayer, and the fact that these materials were not organized in a manner that readily illustrate the nature of the charges, only those charges that are separately listed and specifically state "install" or "installation" will be excluded from Indiana sales tax. If a charge is, say, for "sign package and installation" it will not be excluded from sales tax, since the installation charge cannot be separated from the rest of the "sign package."

Lastly, Taxpayer argues that it is acting as a contractor when it installs the signs at its Indiana customers' locations.

The tax issue raised in this instance does not relate to Taxpayer's obligation as a retail merchant to collect and remit sales tax from its Indiana customers on the sale of the signs and the related delivery charges, etc. The tax issue relates to Taxpayer's own obligation, as a purchaser of tangible personal property (for example, cement, steel, electrical wiring, etc.) it uses to construct the structures upon which it places the signs during installation. IC § 6-2.5-3-2. Pursuant to 45 IAC 2.2-4-23, Taxpayer must pay sales tax to the retailer from whom it purchases the materials, or, if the sales tax was not paid at that point, then, pursuant to 45 IAC 2.2-4-22, Taxpayer must pay use tax to the state where these materials were consumed. The Department's audit, however, did not asses *[sic]* sales or use tax relating to this activity. Therefore, this Letter of Findings merely points to the issue, but does not make

any determinations relating to the assessment of use tax on the construction materials Taxpayer consumes in installing the signs.

In conclusion, the Department's assessment of sales tax on all but the separately stated installation charges stands.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Tax Administration – Ten Percent Penalty.

DISCUSSION

The taxpayer protests the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation 45 IAC 15-11-2(b) clarifies the standard for the imposition of the negligence penalty as follows:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.
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> Additionally 45 IAC 15-11-2(c) states:
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> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:
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> (1) the nature of the tax involved;
> (2) judicial precedents set by Indiana courts;
> (3) judicial precedents established in jurisdictions outside Indiana;
> (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
> (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.
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> Reasonable cause is a fact sensitive question and, thus, will be dealt with according to the particular facts and circumstances of each case. In this case, Taxpayer did not affirmatively establish that its failure to remit Indiana sales tax on its retail sales to Indiana customers was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer is liable for Indiana sales tax except on all charges for those items that clearly and separately state "installation" or "install."

Taxpayer is not relieved of the penalty.

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